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WALTER & WILHELM LAW GROUP
 a Professional Corporation
 Riley C. Walter #91839
 Michael L. Wilhelm #101495
 Holly E. Estes #276933
 205 E. River Park Circle, Ste. 410
 Fresno, CA 93720
 Telephone: (559) 435-9800
 Facsimile: (559) 435-9868
 E-mail: rileywalter@W2LG.com
 E-mail: mwilhelm@W2LG.com
 E-mail: hestes@W2LG.com

Co-Counsel for Elaine Long and George Sarantos

BETTS, RUBIN & MCGUINNESS
 James Betts #110222
 907 Santa Fe Avenue, Suite 201
 Fresno, CA 93721
 Telephone: (559) 438-8500
 Facsimile: (559) 438-6959
 E-mail: br@bettsrubinlaw.com

Co-Counsel for Elaine Long

CORNWELL & SAMPLE
 Stephen Cornwell #40737
 7045 No. Fruit Ave.
 Fresno, CA 93711
 Telephone: (559) 431-3142
 Facsimile: (559) 436-1665
 E-mail: steve@cornwellsample.com

Co-Counsel for George Sarantos

IN THE UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

FRESNO DIVISION

In re

CLUB ONE ACQUISITION CORP,

Debtor in Possession.

TAX ID: 20-8422320
 Address: 11150 Santa Monica Blvd,
 Suite 700
 Los Angeles, CA 90025

CASE NO. 15-14021

DC No.: WW-3

Chapter 11

Date: December 22, 2015
 Time: 3:00 p.m.
 Place: 2500 Tulare Street
 Fresno, CA 93721
 Courtroom 13

Judge: Honorable René Lastreto II

**MOTION FOR SUBSTANTIVE CONSOLIDATION OF BANKRUPTCY CASES
15-14017 AND 15-14021**

TO THE HONORABLE RENE LASTRETO, II, U.S. BANKRUPTCY JUDGE:

Elaine Long ("Long") and George Sarantos ("Santos") (together "Creditors"), by and through their counsel, Walter & Wilhelm Law Group, hereby move this Court for an order substantively consolidating the above captioned Chapter 11 case, CLUB ONE ACQUISITIONS CORP. ("COAC"), with that of Case No. 15-14017 (the "COCI Case") CLUB ONE CASINO, INC. ("COCI"). This Motion is made pursuant to the following points and authorities and any oral argument presented at the hearing hereon.

MEMORANDUM OF POINTS AND AUTHORITIES

A. Background Facts

1. Santos founded COCI in 1995, along with Charles "Bud" Long, each holding 50% of the shares. Declaration of George Sarantos In Support Of Opposition To Motion To Use Cash Collateral And Grant Adequate Protection, And Opposition To Stipulation Re: Final Order Authorizing Final Cash Collateral Use And Granting Adequate Protection [DC- 78] ("Santos Declaration"), pg. 2; and Declaration of Kyle Kirkland in Support of Motion to Use Cash Collateral and Grant Adequate Protection [DC-9] (the "Kirkland Declaration"), pg. 2.

2. In 2002, Bud Long transferred his 50% interest in COCI to his wife, Elaine Long. Santos Declaration, pg. 2; Kirkland Declaration, pg. 2.

3. In July 2006, Santos, Long, and Kyle Kirkland ("Kirkland"), acting on behalf of Kirkland Messina, Inc., signed a letter of intent providing for a new entity to purchase COCI from Santos and Long for \$27,000,000.00. Santos Declaration, pg. 2; Kirkland Declaration, pg. 3. The sale was very highly leveraged.

4. COAC was thus created for the sole purpose of holding the shares of COCI. Santos Declaration, pg. 3; Kirkland Declaration, pg. 3. COAC is a California S-corporation owned 40% by Kyle Kirkland, 40% Dana Messina ("Messina"), 17% by

1 George Sarantos, and 3% by Haig Kelegian. Kirkland Declaration.

2 5. The sale was concluded in 2008 under the terms of a certain Acquisition
3 Agreement. Kirkland Declaration, pg. 3.

4 6. In order to finance the 2008 sale, COAC sought and obtained financing for
5 \$22,500,000 from D.B. Zwirn Special Opportunities Fund. L.P., which later became
6 Fortress Value Recovery Fund I LLC ("Fortress"), a loan which matured in 2012.
7 Sarantos Declaration, pg. 3. COAC claims to have pledged the COCI shares as
8 collateral for the loan, and for which Kirkland and Messina were jointly and severally
9 liable for a \$7,000,000 personal guarantee (subsequently released by Kirkland and
10 Messina when KMGI, Inc. acquired the Fortress loan). Sarantos Declaration, pg. 3;
11 Kirkland Declaration. Both COAC and COCI are obligors on the Zwirn/Fortress/KMGI
12 loan.

13 7. As a part of the sale, Sarantos and Long each received certain cash
14 amounts and each carried a Seller Note in the amount of \$2,500,000 ("Seller
15 Carryback Notes"). Sarantos Declaration, pg. 2. In addition, Creditors left some cash
16 behind which was to be accounted for in the purchase price adjustment to be paid upon
17 completion of an audit on the books (the "PPA") following the sale. Sarantos
18 Declaration, pg. 2. The PPA was to address several factors, including the amount of
19 cash retained by COCI on the closing date that was to be paid to Creditors. Sarantos
20 Declaration, pg. 2.

21 8. Zwirn/Fortress, in providing financing for the sale, required Sarantos and
22 Long to enter into a Subordination Agreement. Sarantos Declaration, pg. 2. The
23 Subordination Agreement provided that, as long as COAC and COCI had a minimal
24 amount of cash on hand, and as long as the Zwirn/Fortress loan was not in default,
25 interest payments on the Seller Notes could be made to Sarantos and Long even
26 before the Zwirn/Fortress loan was paid in full. Sarantos Declaration, pg. 2.

27 9. Almost immediately following COAC's 2008 purchase of Sarantos' and
28 Long's shares in COCI, a dispute arose between COAC and Sarantos/Long regarding

1 the PPA. Sarantos Declaration, pg. 2. Letters were exchanged between the parties in
2 May and August of 2008 in which each provided their calculations regarding the PPA.
3 Sarantos Declaration, pg. 2. An agreement could not be reached, and Creditors filed
4 their demand for AAA Arbitration in December of 2008. Sarantos Declaration, pg. 2.

5 10. In July 2011, the PPA arbitration was resolved entirely in favor of
6 Sarantos and Long, resulting in an arbitration award totaling \$1,966,187. Sarantos
7 Declaration, pg. 3; Request for Judicial Notice in Support of Opposition to Motion to
8 Use Cash Collateral and Grant Adequate Protection, and Opposition to Stipulation re:
9 Final Order Authorizing Final Cash Collateral Use And Granting Adequate Protection
10 [DC-77] ("Request for Judicial Notice"), Exhibit A (the "Arbitration Award"). The
11 Arbitration Award included the PPA (\$1,000,513), plus interest, attorneys' fees, costs
12 and expenses. Arbitration Award, Exhibit A. The Arbitrator, after nine days of
13 testimony, found Kirkland and Messina to have given evasive and inconsistent
14 testimony, grossly misleading statements and "questionable conduct in submitting re-
15 engineered financial statement to Buyer's lender." See Arbitration Award, Exhibit A, pg.
16 17.

17 11. In 2011 the Arbitration Award was reduced to a civil judgment in the
18 amount of \$1,988,923 ("California Civil Judgment"). Sarantos Declaration, pg. 3. The
19 California Civil Judgment included the Arbitration Award amount (\$1,966,187), plus
20 interest. Sarantos Declaration, pg. 3.

21 12. In January 2011, Kirkland and Messina formed KMGI, Inc. for the sole
22 purpose of purchasing the Fortress loan. Sarantos Declaration, pg. 4. Kirkland and
23 Messina are the sole shareholders of KMGI, Inc. Sarantos Declaration, pg. 4; Kirkland
24 Declaration, pg.4.

25 13. In April 2012, Kirkland and Messina through, KMGI, Inc., acquired the
26 Fortress note. Sarantos Declaration, pg. 4; Kirkland Declaration, pg. 4.

27 14. Following a three day bench trial in March 2014, the New York Court
28 Decided in Sarantos' and Long's favor. Request for Judicial Notice, Exhibit B ("New

York Decision"); Sarantos Declaration, pg. 4-5. The New York Court found that the Subordination Agreement does not bar payment on the California Civil Judgment. New York Decision; Sarantos Declaration, pg. 4-5.

15. Shortly after the New York Court ruled in favor of Creditors and designated them as the prevailing party the Creditors returned to the Fresno County Superior Court and they filed a Motion to Amend the California Civil Judgment to add COCI to the Judgment, filed a Motion for Preliminary Injunction, and obtained a temporary restraining order, to stay COCI and Kirkland and Messina from taking certain adverse actions and filed a Motion to Appoint a Receiver. Sarantos Declaration, pg. 5. In response, one day prior to the motion to impose judgment upon COCI based upon alter ego and one week before the continued hearing, COCI and COAC filed for bankruptcy. Sarantos Declaration, pg. 5.

B. Case Background

16. COCI filed its Chapter 11 voluntary petition for relief on October 14, 2015. [DC-1]

17. COAC also filed its Chapter 11 voluntary petition for relief on October 14, 2015. COAC Case [DC-1].

18. On October 28, 2015, COCI filed its Schedules [DC-64] ("COCI Schedules") and Statement of Financial Affairs [DC-65] ("COCI SOFA").

19. COAC also filed its Schedules ("COAC Schedules") and Statement of Financial Affairs ("COAC SOFA") on October 28, 2015. COAC Case [DC-20].

20. Pursuant to the COCI Schedules COCI has an account receivable from COAC in the amount of \$2,758,867.00. [DC-64].

21. On November 19, 2015, COCI filed its Amended Schedules [DC-149] (the "Amended Schedules"). In its Amended Schedules COCI reduced the account receivable from COAC from \$2,758,867.00, to \$565,693.03.

22. COAC listed its only assets as (1) 100% shares in COCI and (2) contingent and unliquidated claims against Clovis 500 Club et. al., [Fresno Superior

1 Court Case No. 15-CE-CG-02704] with an unknown value. COAC Case [DC-20].
2 COCI has also listed an asset of contingent and unliquidated claims against Clovis 500
3 Club et. al., [Fresno Superior Court Case No. 15-CE-CG-02704] with an unknown
4 value in its schedules. [DE -64].

5 23. COAC listed its only creditors as: KMGI, Inc. ("KMGI") in the amount of
6 \$24,290,150 on account of a promissory note; COCI in the amount of \$2,758,867 on
7 account of a "loan to [COAC] for payment of attorney's fees in California and New York
8 state court litigation matters"; Elaine L. Long in the amount of \$1,379,929.65 plus
9 attorney fees on account of an "arbitration award"; George L. Sarantos in the amount of
10 \$1,379,929.65 plus attorney fees on account of an "arbitration award"; and Milbank
11 Tweed Hadley & McCoy, LLP ("Milbank") in the amount of \$1,070,212.69 on account of
12 "Attorneys' Fees and Costs for representation in State Court Litigation." COAC Case
13 [DC-20]. As of the date of this motion, COAC has not amended its schedules to reduce
14 the creditor claim of COCI in the amount of \$2,758,867.00.

15 24. COAC and COCI are co-debtors on the KMGI and Milbank debts. See
16 COAC Schedules and COCI Schedules. See *also* proof of claim filed by KMGI in COCI
17 case, [Claim No. 1] in the amount of \$24,290,150, and proof and claim filed by KMGI in
18 COAC Case, [Claim No. 1] in the amount of \$24,290,150. KMGI is a co-debtor of the
19 Millbank debt.

20 25. Prior to filing the Chapter 11 petitions for relief, Creditors filed a Motion to
21 Amend Complaint to include Club One Casino, Inc., as Alter Ego of Club One
22 Acquisition Corp and Memorandum of Points and Authorities in Support of Motion to
23 Amend Complaint to include Club One Casino, Inc., as Alter Ego of Club One
24 Acquisition Corp. Sarantos Declaration, pg. 5. Accordingly, Creditors assert that
25 COAC and COCI are also co-debtors on the \$1,379,929.65 plus attorney fees owed to
26 Long and Sarantos on account of the Arbitration Award. In any event, Long and
27 Sarantos are substantial creditors of both COAC and COCI.

28 26. Kirkland is the president, director, and 40% shareholder of COAC.

1 Kirkland Declaration. Kirkland is also the general manager, president and director of
2 COCI. See Kirkland Declaration, pg. 2.

3 27. Immediately prior to filing the petitions Messina was the chief financial
4 officer, secretary, director, and 40% shareholder of COAC, and was previously an
5 officer and director of COCI, until his resignation on August 10, 2015. Kirkland
6 Declaration.

7 28. Kirkland and Messina were the sole officers and directors of COCI
8 prepetition, and Kirkland, Messina were the sole officers of COAC prepetition and
9 along with Haig Kelegian, Sr. ("Kelegian"), were the sole directors of COAC prepetition.

10 29. William "Bill" Zender of Bill Zender & Associates, LLC ("Zender"), as
11 alleged by Kirkland, is the newly appointed "independent" director of COCI and COAC.
12 Kirkland Declaration, pg.3.

13 30. A Motion Pursuant to Section 363 of the Bankruptcy Code for Entry of an
14 Order Approving the Engagement Contract of Bill Hughes and Glass Ratner Advisory &
15 Capital Group, LLC ("Glass Ratner") [DC-51], is pending before the court and set for
16 hearing December 17, 2015 at 10:00 a.m.. Bill Hughes is alleged to be COCI's new
17 chief restructuring officer. Kirkland Declaration, pg.3. Hughes is an alleged officer, but
18 not a director of COCI. Kirkland Declaration, pg.3.

19 31. COCI's directors are now Kirkland, Zender, and Kelegian, and its officers
20 are Kirkland and Hughes. COAC's directors are Kirkland and Zender, and Kirkland is
21 COAC's only officer.

22 32. COCI and COAC both use Baker, Peterson & Franklin, CPA, LLP as their
23 accountant. See COAC SOFA and COCI SOFA.

24 33. COCI and COAC file consolidated tax returns. COCI and COAC provide
25 consolidated financial statements. See COAC SOFA and COCI SOFA. COAC has no
26 business activity, no employees, no bank accounts and no revenues. COCI pays
27 COAC's bills, and COAC claims COCI's revenues as its own. Kirkland Declaration, pg.
28 3, ¶ 7.

34. On November 2, 2015, COCI filed its Motion For Order Directing Joint Administration Of Related Cases Pursuant To Federal Rule Of Bankruptcy Procedure 1015(b) [DC-71] (the "Motion for Joint Administration"). This motion is set for hearing on December 2, 2015 at 2:30 p.m.

35. On November 3, 2015, COAC filed its Motion For Order Directing Joint Administration Of Related Cases Pursuant To Federal Rule Of Bankruptcy Procedure 1015(b) [DC-22]. This motion is set for hearing on December 2, 2015 at 2:30 p.m.

C. Legal Analysis

The power of the bankruptcy court to substantively consolidate derives from the court's general equity powers codified in 11 U.S.C. §105. *In re Bonham*, 229 F.3d 750, 764 (9th Cir. 2000). "Substantive consolidation is a mechanism whereby the assets and liabilities of two or more related entities are pooled to create a single fund from which creditors of the combined estate may receive distributions." *In re Wade Cook Fin. Corp.*, 375 B.R. 580, 598 (B.A.P. 9th Cir. 2007) (citing *In re Bonham*, 229 F.3d at 764).¹ Essentially, it ignores the corporate form when entities are so intertwined that it makes no sense to devote resources to disentangle them. *Id.* Creditors of the consolidated entities are combined for purpose of voting on reorganization plans. *In re Bonham*, 229 F.3d at 764. The primary purpose of substantive consolidation is to ensure the equitable treatment of all creditors. *Id.*

The Ninth Circuit has adopted the Second Circuit's approach to substantive consolidation. *See Id.* When considering when to substantively consolidate courts should consider two factors (1) whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity when extending credit; or (2) whether the affairs of the debtor are so entangled that consolidation will benefit all creditors. *Id.* at 766 (citing cases). The presence of either factor is sufficient for a court to order substantive consolidation. *Id.*

¹ Substantive consolidation is also contemplated by Fed. R. Banker. P. 1015.

1 In the present case, the facts of the two estates satisfy both tests. Here, COAC
2 does not exist without COCI. COAC is a shell corporation whose only real asset is the
3 stock it holds in COCI. COAC has no bank account, no employees and no business
4 activity. Prepetition, COAC and COCI had the same officers and directors –Kirkland
5 and Messina (Kelegian was also a director from COAC, but not COCI). Post-petition,
6 COAC and COCI have substantially similar directors –Kirkland and Zender (Kelegian is
7 also a director of COAC, but not COCI), and substantially similar officers, Kirkland (Bill
8 Hughes is the only other alleged officer of COCI, but not COAC). COCI has been used
9 to pay COAC's bills. COAC has never maintained normal business books and records,
10 but instead adopts those of COCI as its own.

11 Substantive consolidations of the two estates is in the best interest of creditors
12 and the estates. Here, COAC owes COCI over \$500,000.00. If these cases are
13 substantively consolidated, Creditors ask that the Court eliminate that claim for plan
14 purposes, so that this interdebtor claim is not classified, and does not receive any
15 distribution under the plan.

16 It is in the best interest of creditors and the estate to reduce the costs associated
17 with administering these chapter 11 estates including the costs of having two separate
18 counsel, the costs that would otherwise be associated with filing two separate
19 disclosure statements and plans of reorganization, the costs associated with filing
20 separate monthly operating reports and two separate U.S. Trustee's fees. If these
21 cases are consolidated, there is only need for one counsel, one monthly operating
22 report, one U.S. Trustee fee, one disclosure statement and plan of reorganization, one
23 accounting firm to preform services on behalf of the estates etc.

24 There is no logical reason not to substantively consolidate these two cases.
25 COAC's assets consist of its 100% ownership interest in the stock of COCI and a
26 contingent unliquidated claim associated with a law suit that it has commenced along
27 with COCI against the 500 Club. COAC's only creditors are those which it is a co-
28 debtor with COCI. There is no purpose in separately administering two separate

1 estates, when the assets and debts of COAC are those shared with COCI. Additionally,
2 COAC has no ability to propose a plan of reorganization that would be independent of a
3 plan of reorganization proposed by COCI. COAC has no business other than owning
4 COCI.

5 As noted above, COAC and COCI have filed Motions for Joint Administration of
6 the two cases. Joint administration only gets us half way to the best result. Substantive
7 consolidation completes the process. Substantive consolidation of these two estates is
8 the only logical conclusion. Even the Debtors' own arguments in their Motions for Joint
9 Administration support substantive consolidation including: reducing costs; a single
10 disclosure statement and plan of reorganization; the debtors are affiliates and under
11 common control; debtors share common management; and debtors share common debt
12 and creditors. See Motion for Joint Administration, pg. 3-4. Joint administration would
13 still result in the unnecessary administrative burden of two monthly operating reports
14 and two U.S. Trustees fees. Additionally, Joint Administration would still allow for these
15 two debtors to be viewed as separate entities with separate assets and separate
16 liabilities, which is not the case. COAC's assets and liabilities are those shared with
17 COCI.

18 The equitable treatment of all creditors is best served by substantively
19 consolidating the two estates so that the assets and liabilities of the two estates are
20 pooled to create a single fund from which creditors of the combined estate may receive
21 distributions under a plan of reorganization.

22 The benefits of substantive consolidation greatly outweigh any harm. Substantial
23 debt is commonly owed by the debtors, and there is no prejudice to creditors in
24 combining the estates of the debtors. In addition, substantive consolidation will
25 substantially decrease administrative expenses of bankruptcy, such as additional cost of
26 attorneys, financial advisors and accountants.

27 WHEREFORE, Creditors pray that the Court enter an Order substantively
28 consolidating Club One Casino, Inc. Case No. 15-14017 and Club One Acquisition

1 Corp., Case No. 15-14021 under the primary case Club One Casino, Inc, Case No. 15-
2 14017, and that the Court:

3 (1) Treat the assets of each Debtor estate as being a single estate;

4 (2) Treat all claims as being a claim against the consolidated single estate,
5 preserving the priority of each creditor under §726;

6 (3) Eliminate claims among the Debtors for plan purposes, so that these
7 interdebtor claims are not classified, do not vote, and do not receive any distribution
8 under the plan;

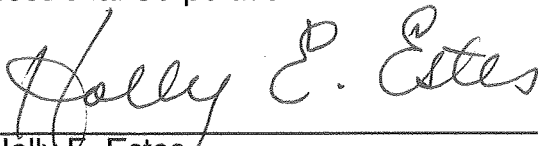
9 (4) Eliminate duplicate claims by the same creditor filed against more than
10 one debtor; and,

11 (5) Grant Creditors such other and further relief as is just and proper.

12 Dated: November 20, 2015

13 WALTER & WILHELM LAW GROUP,
14 a Professional Corporation

15 By:


16 Holly E. Estes,
17 Co-Counsel for Elaine Long and
18 George Sarantos
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